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Comments to the International Tax Working Group

Mr. Chairman, Ranking Member Wyden and Senators Portman and Schumer

The NFTC appreciates the commitment of Chairman Hatch, Ranking Member Wyden, and the Senate Finance Committee and the working groups to comprehensive tax reform. We commend the Committee for engaging stakeholders and for conducting an open and transparent process.

The NFTC, organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and we seek to foster an environment in which worldwide American companies can be dynamic and effective competitors in the international business arena.

The NFTC comments provide some background on comprehensive tax reform, a discussion of the current U.S. tax structure, and recommendations to enhance the ability of worldwide American companies to compete in the global market as well as their ability to invest and create jobs in the United States.

Comprehensive Tax Reform

As discussed in more detail below, comprehensive tax reform is necessary to address the changing global landscape, making the U.S. economy more attractive for investment and job creation. It has been over a quarter century since Congress has reformed the tax code. During this time, global commerce has changed dramatically and many foreign countries have responded to this change by updating their international tax regimes. The United States however, continues to lag in its response to the new global landscape. For example, in 1960 nearly all of the largest global companies were American companies, with 17 of the 20 largest companies headquartered in the U.S. In 1985, only 13 of the 20 largest companies were American companies, and as of 2010, only six of the 20 largest companies in the world were American. This represents a decrease of 55% since 1960. Since 1985, Brazil, China, India Russia and Eastern Europe moved from essentially non-market economies to fast growth developing countries whose markets have opened to global companies from the United States, Europe, Japan, China, Korea, and India. This very competitive marketplace is wide open.

To keep pace with this ever-changing global landscape, Congress should enact comprehensive

tax reform legislation that:

1. Lowers the U.S. corporate income tax rate in line with the rates of our trading partners to attract and retain investment in the U.S;
2. Adopts a competitive territorial tax system that imposes minimal residual home country taxation on foreign earnings without expense allocation much like those in most of the rest of the world which would allow American companies to compete on equal footing with their foreign competitors in the global marketplace;
3. Permits American companies to invest foreign earnings in the U.S. without a tax penalty, and
4. Does not disadvantage any particular industry or type of income vis-a-vis other industries or types of income.

Until such time as comprehensive tax reform can be enacted, piecemeal changes should be avoided. In particular, a robust, fully-functioning foreign tax system that prevents double taxation of U.S. companies under the existing worldwide system needs to stay in place.

The U.S. Should Reduce the Corporate Income Tax Rate

The current combined U.S. federal corporate income tax rate of 39.1% (35% federal rate plus state income tax rate) is the highest combined corporate income tax rate among the member countries of the Organisation for Economic Co-operation and Development ("OECD"). Indeed, in the world, only the Democratic Republic of the Congo and Guyana have a higher rate. The U.S.'s combined rate is nearly 15 percentage points higher than the 25% average corporate tax rate among OECD member countries.1

The United States will clearly benefit from a substantial reduction in the corporate tax rate. A lower corporate tax rate will boost investment, entrepreneurship, and productivity in the United States. Companies will have an incentive to locate their headquarters and create more work locations in the United States, which will in turn create new job opportunities and improve the U.S.'s economic outlook. A reduction in the corporate income tax rate also will help attract and retain more U.S. investment, including foreign direct investment, also resulting in additional jobs and tax revenue. The statutory rate is the rate that is the key measure of the net after-tax rate of return on a given investment project.

Furthermore, it very difficult for global American companies to compete with foreign companies that have the benefit of a lower corporate income rate within their respective countries. Other countries have recognized the competitive advantages of a lower corporate income tax rate and responded accordingly. Over the past six years, 75 countries have cut their

1 *See* 2012 OECD Tax Database, Table II.1. 25.1% is the average combined corporate rate among OECD countries, not including the U.S.

corporate income tax rates in order to promote investment and create jobs.2 For example, Canada lowered its federal rate from 18% to 16.5% and has plans to further reduce the rate to 15%. Similarly, the United Kingdom lowered its rate from 28% to 20%. These examples demonstrate the continued lack of competitiveness of the U.S. corporate tax system, which ultimately results in slower economic growth and impedes the creation of jobs in the United States.

The high U.S. corporate income tax rate also provides a barrier to American companies seeking to expand through foreign acquisitions. Foreign-based companies that benefit from lower tax rates can typically outbid American companies for foreign targets. This makes it more difficult for worldwide American companies to enter new markets and prevents these companies from reaping the benefits of increased market share, access to key customers, cost synergies, and efficiency gains. In this regard, the United States should adopt a corporate tax system that places worldwide American companies on an equal footing with their competitors.

American companies are currently the target of several global tax initiatives, including the OECD Base Erosion and Profit Shifting (BEPS) project, the E6 project on the taxation of the digital economy and the EU tax and transparency project. The BEPS project highlights the importance for companies and tax administrators of the consistent application of tax rules across jurisdictions. The U.S. worldwide tax system, puts the U.S. at a distinct disadvantage, but a reformed U.S. tax system could alleviate some of the problems that the BEPS project is trying to address. If the U.S. adopts a minimum tax, or interest allocation restrictions, it would fall further outside the OECD norms and become even more of a tax outlier.

To compete in the global marketplace, American companies must try to use all legal means possible to reduce their corporate tax rate to a level close to their main competitors. The high U.S. corporate statutory tax rate has been mentioned by other governments as a cause of profit shifting into lower taxed jurisdictions, which many cite as a cause of base erosion. By trying to effectively compete with companies from lower tax jurisdictions, U.S. multinationals are now the primary target of the BEPS project and other governments are looking for ways to raise additional revenue from these U.S. companies, effectively trying to strip that revenue from the U.S. fisc.

The U.S. Should Implement a Competitive Territorial Tax System

In addition to its high statutory corporate income tax rate, the United States also taxes American companies on their worldwide earnings. The U.S. tax system provides temporary relief to companies through deferral of tax on the active business earnings for foreign subsidiaries until those earnings are repatriated. In other words, American companies can decide either to reinvest foreign profits in their foreign operations or to bring those profits back to the United States with the likely consequence of having to pay significant residual U.S. tax on those profits reducing the profits available for U.S. investment. Non-American companies, on the other hand, may freely invest their non-U.S. earnings in the U.S. without a tax penalty.

2 Tax Foundation Special Report, "Ten Benefits of Cutting the U.S. Corporate Tax Rate," No. 192 at 3 (May 2011).

The U.S. worldwide tax system creates artificial barriers to investment within the United States and discourages investment in US markets so as to avoid the penalty. Conversely, most other countries operate under territorial systems that allow foreign-based companies to deploy capital around the world, including in their home country, without additional home country taxation on the returns to those investments.

Of the 34 OECD member countries, 26 use a territorial system, with only the remaining eight, including the U.S., using a worldwide system.3 Importantly, 18 of the 26 countries using a territorial system provide for a 100% exemption of foreign subsidiary earnings from home country taxation, and none require home country expense allocation.4 By switching to a competitive territorial system, the United States would encourage businesses both at home and abroad to invest in the United States. The switch would also align the United States with its global trading partners, including Canada, the United Kingdom, Germany, France, and Japan. In this regard, a move to a territorial system would place the American economy and American companies on a level playing field with competitors throughout the world. Further, a competitive territorial system would make the United States a more attractive place to locate company headquarters, new plants and service locations, which would ultimately lead to additional job opportunities in the United States.

The U.S. Should Not Adopt Discriminatory Taxes

The Administration's Budget contains a proposal to impose a 14% one-time tax on previously untaxed foreign income. The proposal would require U.S. multinational corporations with controlled foreign corporations (CFC) to pay tax at the 14% rate on tax-deferred earnings accumulated in those subsidiaries. In 2014, then-Ways and Means Committee Chairman Dave Camp's tax reform proposal contained a much more scaled back deemed repatriation tax of 8.75%, and provided for two different levels of that tax to take into consideration the lack of liquidity in foreign operations of traditional brick and mortar companies by providing for a second tax of 3.5%. The Administration's tax rate is more than twice the rate specified by Chairman Camp, and does not differentiate between cash and non-cash assets. This mandatory, retroactive tax would fall on companies reinvesting their foreign earnings to expand markets for U.S. goods and services, making it even more difficult for U.S. companies to effectively compete overseas

The budget also imposes a minimum tax on the overseas earnings of U.S. multinational corporations at a rate of 19%. This proposal would repeal the current system of tax deferral for undistributed non-subpart F income of CFC. Instead of U.S. tax being deferred until repatriation, a minimum U.S. tax would apply each year to all non-subpart F income except for the amount of an allowance for corporate equity. Former Chairman Camp's tax reform proposal also contained a minimum tax proposal. A U.S. parent of a foreign subsidiary would be subject to current U.S. tax on a new category of Subpart F income, "foreign base company intangible income" (FBCII) equal to the excess of the foreign subsidiaries gross income over

3 Business Roundtable, "Taxation of American Companies in the Global Marketplace: A Primer," at 14 (April 2011).

4 *Id.*

10% of the foreign subsidiary's adjusted basis in depreciable tangible property. The U.S parent could claim a deduction equal to a percentage of the foreign subsidiary's FCBII that relates to property that is sold for use, consumption or disposition outside the U.S. or to services that are provided outside the U.S. In an article for Tax Analysts in 2014, Martin Sullivan estimated that up to 80% of earnings would be captured by the FBCII provision. It may be that what was intended as a base erosion protection actually ended up covering a much broader amount of earnings than was intended by Chairman Camp.

There are no minimum taxes imposed on worldwide income in the tax systems of our major competitors. The application of minimum taxes, along with the loss of deferral, will make the U.S. less competitive than it is under current law. No developed country imposes a worldwide tax system without deferral. If deferral is eliminated without a full, or almost-full (95%) exemption, U.S. companies will be subjected to an uncompetitive level of taxation in excess of current law. The Administration's proposal to levy a new $270 billion tax on existing foreign operations is both misguided and punitive.

U.S. taxpayers reasonably relied on current law which does not impose this tax on deferred active foreign earnings. Investment decisions were modeled and made on this basis, resulting in detrimental reliance if this "transition tax" proposal is enacted. For many U.S. companies, prior investments of foreign profits in growing their foreign business operations reduce their cash available to pay this tax, creating potentially severe liquidity issues for these companies. Second, foreign competitors of U.S. companies in markets around the world do not face current taxation of active foreign business income in their home countries. U.S.-based firms would be required to bear an income tax liability that would be a serious additional cost burden that would, over time, severely restrict their ability to compete. In such an environment, there would be a greater likelihood of foreign acquisition of US headquartered companies.

The Administration's budget also restricts the deduction for disproportionate interest expense of U.S. members of worldwide groups. This proposal would limit the net interest expense deduction of a U.S. corporate taxpayer that is a member of a worldwide consolidated group to the U.S. member's proportionate share of the worldwide group's net interest expense. The Administration's proposal is also the subject to an Action Item in the BEPS project.

Foreign governments do not allow a U.S. - owned CFC to deduct interest expenses on debt of a U.S. shareholder. If the U.S. would disallow any deduction for U.S. corporate interest expense, there would be no deduction in any jurisdiction. This result is contrary to the principle that income tax is imposed on "net income" after allowance for ordinary and necessary business expenses. A debt financed investment in a U.S. plant would be more costly for the U.S. company than for the foreign headquartered company. While the NFTC understands why some limitation on interest expense is being considered, we have signification concerns that proposals that would deny a deduction for an arbitrary percentage of interest expense, or any other restrictions on interest deductions, such as the denial of a deduction based on a formulaic allocation of interest or the creation of an unreasonably low threshold of deductible interest, could have a negative impact on borrowing and capital investment.

Changes in the deductibility of interest would also make it more difficult for foreign companies doing business in the U.S., and would make the U.S. a less welcoming tax environment for

foreign investment into the U.S. The NFTC is concerned about proposals to further limit interest deductions for U.S. subsidiaries of foreign-headquartered corporations and eliminating their ability to carry forward excess interest expense to future tax years. Proposals like these disregard the important role that foreign direct investment plays in the U.S. economy and discriminates against non-U.S.-headquartered companies that play an important role in the U.S. economy and U.S. communities. The ability to deduct interest expense is a critical factor in a company's decision to invest and create jobs in the United States.

The NFTC recognizes that artificial transactions designed to erode the U.S. tax base should be curtailed. On the other hand, NFTC member companies believe that U.S. companies should continue to be able to plan business affairs properly while reducing the amount of foreign tax that would otherwise be incurred. Over-reaction to so-called "foreign base erosion" could give an unintended advantage to foreign headquartered companies.

Neutrality Among Industries and Type of Income

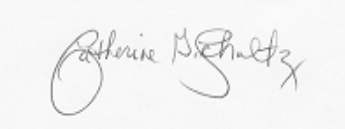
Finally, comprehensive tax reform legislation should promote neutrality among industries, types of income, and taxpayers, i.e. it should avoid policies favoring one industry or type of income over another or discriminate against one taxpayer versus another engaged in the same or similar activities.

Conclusion

We continue to strongly support Chairman Hatch's commitment to pass comprehensive tax reform. The Chairman has recognized how today's uncompetitive tax code is already leading to the loss of U.S. companies.

Thank you for the opportunity to submit these comments. The NFTC looks forward to working with you, your staffs, and all Members of the Committee to ensure that U.S. comprehensive tax reform facilitates and enhances the competitiveness of the U.S. economy and of globally engaged American companies.

Sincerely,



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